

IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON : 21.11.2016

PRONOUNCED ON : 12.04.2017

Coram:

The Hon'ble Mr.Justice NOOTY. RAMAMOHANA RAO

AND

The Hon'ble Dr. Justice ANITA SUMANTH

TAX CASE (APPEAL) No.2695 of 2006

The Commissioner of Income Tax,
Chennai.

.. Appellant

vs

M/s.Alankar Business Corporation Ltd.,
(formerly Chennai Bottling Co. Ltd.)
No.423, Poonamallee High Road,
Arumbakkam, Chennai.

.. Respondent

Appeal filed under Section 260A of the Income Tax Act, 1961
against the order of the Income Tax Appellant Tribunal, Madras 'A'
Bench, dated 12.06.2006 in ITA No.1017/Mds/2005.

For Appellant .. Mr.T.Ravikumar

For Respondent.. Mr.V.S.Jayakumar

JUDGMENT

(Judgment of this Court was delivered by ANITA SUMANTH, J.)

1. This Tax Case Appeal is filed at the instance of the Income Tax Department in relation to the assessment year 1999-2000 raising the following substantial questions of law for our consideration:

a) Whether on the facts and circumstances of the case, the Tribunal was right in holding that the value of the broken bottles need not be reduced from the written down value for the purpose of calculation of short term capital gains arising from sale of bottles?

b) Whether in the facts and circumstances of the case, the Tribunal was right in holding that lease compensation charges should be treated as a revenue expenditure?

c) Whether in the facts and circumstances of the case, the Tribunal was right in holding that the amount of Rs.3 crores received as sale consideration in respect of goodwill should not be assessed to long term capital gains?

2. The Assessee/Respondent is engaged in the manufacture of Soft drinks under a franchise from Coco Cola. It had two bottling plants, Unit I at Poonamallee High Road, Arumbakkam and Unit II at Pulianthope, Trivellore District, Nemam. The assessee, in the previous year relevant to the present assessment year, entered into an arrangement for transfer of its entire soft drinks and beverage undertaking as a going concern to Hindustan Coco Cola Bottling South West Pvt. Ltd (in short 'HCC').

3. The first issue raised in the appeal relates to the reduction of the value of breakages of bottles and crates from the written down value ('WDV') in the computation of short term capital gains u/s 50 of the Income tax Act 1961 (the 'Act'). The Assessee had sold bottles and crates to HCC offering short term capital gain of an amount of Rs.8,28,97,258/- to tax in terms of section 50 of the Act. In doing so, WDV was adopted at Rs.12,02,56,812/-. Separately, the assessee accounted for breakages of bottles and crates at the rate of 15% as against 33% for earlier years. The realization from the sale of broken bottles and crates was offered to tax. The assessing officer was of the view that the value of breakages should be deducted from the WDV adopted for bottles and crates, whereas, according to assessee, the breakages had

already been taken into account in its statement of income by way of suo moto disallowance and there was thus no need to reduce the same once more from the WDV. However, the assessing officer noted that the sale to HCC as on 28.02.99 could only be of the bottles existing as on that date which could not have included the broken bottles and crates. Thus, he estimated the breakages at a figure of Rs.1,88,47,376 reducing the same from WDV. The short term capital gain stood enhanced to Rs.10,54,18,206/- in place of Rs.8,28,97,258/- computed by the Assessee.

4. The second issue related to the allowability of an amount of Rs.1,84,63,029/- being compensation charges. The Assessee had claimed the same in terms of Section 36(1)(iii) of the Act or alternatively as a revenue outgo in terms of Section 37(1) of the Act. The Assessing Officer was of the view that the compensation charges were capital in nature and disallowed the same. The third adjustment related to an amount of Rs.3 crores representing goodwill that, according to the assessee was liable to tax in AY 2002-03 and not in the year under consideration. The assessee submitted that the actual closure of business was conditional on the completion of various statutory formalities and produced a letter from the purchaser HCC to the effect that the sum of Rs.3 crores

constituted only an advance in respect of which a Bank Guarantee had been given by the Assessee. The submission was negated by the Assessing Officer, who noted that the Assessee had, as on 28.02.1999, stopped manufacturing operations and was only rendering job work for HCC. The Assessing Officer drew support from the Annual Report of the Company for the year ending 31.03.1999 that corroborated this position and reflected the closing stock as Nil. Thus the Assessing Officer brought to tax the amount of Rs.3 crores in the present assessment year being of the view that the transfer of goodwill business had been effected in the present year itself.

5. In appeal before the Commissioner of Income Tax (Appeals) all issues were held against the Assessee. The order was assailed in appeal before the Income Tax Appellate Tribunal, which held the issues in favour of the assessee. The aforesaid order of the Tribunal dated 12.06.2006 is challenged in appeal before us.

6. We have heard the submissions of Mr.T.Ravikumar, learned counsel appearing for the Income Tax Department and Mr.V.S.Jayakumar, and Mr. Sandeep Bagmar, learned counsels appearing for the Assessee/Respondent.

7. Adverting to the issue of computation of short term capital gain, the assessee has been consistently providing for breakage of bottles and crates, 33% in the present year as against 15% in the past, adding the same back for the claim of depreciation. The assessee also did not claim the loss from breakage since it was capital in nature. The income from sale of bottles was being offered as income. This practice has been accepted by the department on all counts. In the financial year relevant to the present assessment year, the assessee transferred the assets to the purchaser and this gave rise to short term capital gain computed in terms of section 50 of the Act, relating to depreciable assets. Section 50 reads thus:

'50. Notwithstanding anything contained in clause (42A) of section 2, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed under this Act or under the Indian Income tax Act 1922 (11 of 1922), the provisions of sections 48 and 49 shall be subject to the following modifications:-

(1) where the full value of the consideration received or accruing as a result of the transfer of the asset together with

the full value of such consideration received or accruing as a result of the transfer of any other capital asset falling within the block of assets during the previous

year, exceeds the aggregate of the following amounts, namely:-

(i) expenditure incurred wholly and exclusively in connection with such transfer or transfers

(ii) the written down value of the block of assets at the beginning of the previous year; and

(iii) the actual cost of any asset falling within the block of assets acquired during the previous year;

such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets

(2) where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred

during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

8. In accordance with the provisions of section 50, where a capital asset forms part of a block of assets and depreciation has been allowed in regard to the same, then, in the computation of capital gain on the transfer of such asset, the cost of acquisition shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block acquired during the previous year. In the present case, the WDV as on 1.4.1998 is Rs.12,02,56,812/- after reducing the depreciation allowable. In such an event, and in the light of the fact that the breakages have not been claimed in the

computation of income, there is no justification for any further reduction from WDV. The case law relied upon by the assessing officer have been rightly distinguished by the Tribunal as they turn on entirely different facts. Substantial Question No.1 is answered against the Revenue and in favour of the Assessee.

9. Adverting to Substantial No. 2, the Assessee had set up a new plant in Nemam to commence production from March 1997. In this regard, an 'Agreement to enter into Lease' dated 23.2.1995 was entered into between the assessee and M/s.Sundaram Finance Limited ('SFL') for financing of the plant and machinery, at the behest of the assessee and subsequent lease thereof by SFL to the assessee. The agreement provided for various terms and conditions for the intended lease including the payment of compensation charges at the rate of 21% in the following terms:

' 6.The intending lessee further declare, confirms and assures the intending lessor as follows:

a)

b)

c)

d) That he shall pay compensation charges, at 21% per annum at monthly rests or any amount advanced by the intending lessor to the manufacturer/supplier, from the date such payment till the date of the lease agreement to be entered into. In

the alternative, the intending lessee may also remit the advance payment which will be reimbursed by the intending lessor, at the point of delivery of the equipment and the simultaneous signing of the lease agreement to be entered into.'

10. Thereafter, and after a gap of nearly two years, a lease agreement was entered into between the parties on 25.03.1997 for lease of the factory for a period of seven years. The assessee intended originally, to defer the claim of compensation charges/interest payment over a period of seven years, i.e., during the period of lease. However, since the plant and machinery had been sold during the financial year under consideration, the lease agreement was terminated and the entire balance outstanding interest was claimed in the present year. The claim, in terms of section 36(1)(iii), was rejected on the ground that there was no borrowal by the assessee per se. The alternate claim under section 37 was also rejected on the ground that the expenditure was capital in nature.

11. The assessee would submit that the compensation charges were in the nature of interest payments. In fact, the assessee had made a claim of 1/7 of the interest for the previous

assessment year, and the claim had been accepted by the assessing officer after verification in scrutiny. With respect to the claim u/s 37 of the Act, the assessee would state that the new plant at Nemam constituted an extension of the existing business and not a new business. The expenditure was revenue in nature, also allowable u/s 37 of the Act.

12. The rejection of the claim u/s 36(1)(iii) was for the reason that the assessee was not per se, the borrower of the funds. However the agreement dated 23.2.1995, while providing for the financial assistance extended by SFL for the purchase of the plant and machinery, also provides for the subsequent lease of the machinery to the assessee. Thus, the arrangement with SFL for financing the acquisition and leasing of the equipment is only for the business purposes of the assessee. The provision of compensation charges is in the nature of the interest liability payable to the manufacturer or supplier of the equipment by SFL that the assessee makes good. The sum and substance of the arrangement is that the assessee engages the services of SFL for rendering financial assistance for acquisition of equipment for its business. SFL, while advancing the funds, negotiates the purchases of the equipment and the assessee undertakes to pay charges at the rate of 21% to compensate SFL for the advances made by it to the manufacturers

and suppliers of equipment. We are thus of the view that the assessee assumes the role of the borrower in this situation. The compensation charges paid are in the nature of interest, liable to be allowed in terms of section 36(1)(iii) of the Act.

13. With respect to the alternate plea under section 37 of the Act, the equipment has been acquired for the expansion of the business of the assessee. The second unit at Nemam is also engaged in the bottling of beverages under the existing franchisee with Coco Cola. Thus, while a new asset is acquired, it is for the purpose of the expansion of the existing business of the assessee and not for the development of a new line of business. The charges paid are consequently allowable u/s 37 of the Act being wholly revenue in nature. Substantial Question No.2 is thus answered against the Revenue and in favour of the Assessee.

14. Now we address the question of goodwill. The assessee and HCC had negotiated for the transfer of the beverage division as a going concern. This division, referred to as the 'Acquired Business Undertaking' was proposed to be transferred in a phased manner, defined as the stages of pre-closing and closing. An Agreement

dated 28.2.99 was entered into for the transfer of goodwill and a Business Purchase Agreement dated 27.3.99 was entered into that set out the terms and stages of the transfer. The limited question that arises before us is the year of taxability of the consideration received for the sale of goodwill. Revenue would contend that the consideration was taxable in the present year, whereas the assessee would state that the transfer and the consequent liability to tax was in A Y 2002-03. It would also point out that the amount had been offered to tax in assessment year 2002-03 and accepted by the assessing officer. A perusal of the agreement dated 28.02.1999 between HCC and the Assessee reveals the following:

'2.The seller hereby sells and the buyer hereby purchases the goodwill of the seller as valued by the seller for a consideration of Rs.3,00,00,000/- (Rupees Three Crores only) (the 'Consideration') the receipt and sufficiency whereof is hereby acknowledged by the seller.'

.....

'20. Entire Agreement – Amendment – Supremacy

This document sets forth the entire understanding between the parties relating to the subject matter contained herein and supercedes all other agreements and

*undertakings entered into between the parties
prior hereof.'*

15. The parties have thus unequivocally transacted for the transfer of goodwill as on 28.02.1999. The vendor, the Assessee herein, represents that as on the date of sale, there are no encumbrances whatsoever in respect of the goodwill and the parties agree that the document sets forth the entire understanding between them relating to the subject matter. There is nothing whatsoever to indicate that the agreement was tentative or that the transfer was incomplete or subject to other stipulations. The finding of the Tribunal to the effect that the consideration on account of goodwill was not received is contrary to Clause No.2 extracted above wherein the vendors specifically confirm the receipt thereof. The execution of a Bank Guarantee as well as the Letter dated 28.03.2002 by HCC where the payment of Rs.3 crores is shown as an advance has to be seen in the context of the agreements between the parties and the suspension of the business of the assessee as on 28.02.1999.

16. We are thus of the view that the Tribunal erred in deleting the addition on account of goodwill when the same has, as a fact, been transferred as on 28.2.1999 and full consideration received

then and there. The amount representing goodwill is thus liable to be taxed in the present year. The conclusion of the Tribunal stands reversed and that of the Assessing Officer in this regard restored. Consequently, the amount shall stand reduced from the taxable income in respect of assessment year 2002-03.

17. Substantial Question Nos.1 and 2 are answered in favour of the Assessee and against the Revenue and Substantial Question No.3 stands answered against the Assessee and in favour of the Revenue. The Departmental Appeal is disposed in the above terms. No costs.

(N.R.R.,J) (A.S.M.,J)

12.04.2017

Index: Yes/No
Vga/msr

NOOTY. RAMAMOohana RAO, J
AND
Dr.ANITA SUMANTH,J

PRE DELIVERY JUDGMENT IN
T.C.A.No.2695 of 2006

12.04.2017